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**Financial Assessment of Executive Decision-Making and Risk Management: A Case Study
of AutoZone**

by

Carolina Hollis

A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the
requirements of the Sally McDonnell Barksdale Honors College.

Oxford, Mississippi

May 2024

Approved by



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ABSTRACT

FINANCIAL ASSESSMENT OF EXECUTIVE DECISION-MAKING AND RISK MANAGEMENT: A CASE STUDY OF AUTOZONE

This area of investigation pertains to the business organizational structure, executive summary, and risk management decisions of AutoZone within the 2022-2023 fiscal year. This analysis was performed by examining previous financial records, the yearly 10-K report, and various research databases regarding the financial performance of retail auto part companies. Many different sources were used to gather information about AutoZone. AutoZone has an intricate financial system that maintains the going concern by addressing current issues within the financial world to combat problems they could face in the future. These risk factors include inflation, interest rates, energy prices, political climates, and supply chain threats. All of which could manifest themselves in the financial results of AutoZone's reports.

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CHAPTER I: AN OPERATIONAL RISK ASSESSMENT

I. Introduction of Methods of Analysis

The area of investigation of this case study is the operational risk assessment of AutoZone. This case study analyzes the organizational structure, risk factors, and threats to the success of AutoZone. Many different sources were used to gather information about AutoZone. The primary document used was the yearly 10-K report filed by the company's management. We also used several articles from the business press. In addition, we analyzed reports from news websites and blogs including *MarketWatch*, *SeekingAlpha*, and *YahooFinance*. Multiple search engines such as Google, Bing, Yahoo, and DuckDuckGo were used to obtain a variety of unbiased results.

The main tasks of this report were three-fold. First, we studied the organizational structure of the company. This involved analyzing the org-chart to determine the hierarchy of executives in this organization. There are also many subsidiaries of AutoZone. These subsidiaries focus on different areas of the company's operations and different locations of operations. We also discussed risk factors that could manifest themselves in the financial results of AutoZone. These factors include inflation, interest rates, energy prices, supply chain, political climate, and global unrest. Finally, we determined the main threats to the success of the company and how we would mitigate these risks.

We learned many new skills while working on this case. First, we learned how to conduct in-depth research of a specific company using online databases, news articles, and the

blogosphere. We then consolidated this information into bullet points and short phrases.

Teamwork was also an important aspect of this case study. Instead of delegating specific tasks to each group member, we researched every prompt as a group. Overall, we gained many new skills while conducting this case study.

II. Organizational Structure

AutoZone is a publicly traded company on the New York Stock Exchange. It is a retailer and distributor of automotive parts and accessories in the United States. As of 2020, AutoZone operated over 6,000 stores across the United States. The company is headquartered in Memphis, Tennessee. The company's stores are primarily located in the southern United States. However, they are an international company with stores all across the world.

Since AutoZone is a large corporation, its leadership is broken up into different groups, including the Chief Executive Officer, Board of Directors, Executive Committees, Customer Satisfaction Teams, Merchandising, Information Technology Teams, Store Operations, Finance, and Human Resources. The board is composed of former directors and Chief Executive Officers of other companies, and the Executive Committees include executive vice presidents, senior vice presidents of marketing, customer satisfaction, merchandising, information technology, store operations, finance, and human resources.

AutoZone also owns various subsidiaries that allow them to broaden their customer reach as well as be more efficient in product production. Some of these include Alldata LLC, AutoZone.com Inc., AutoZone de Mexico, AutoZone Development LLC, AutoZone IP, AutoZone Parts, AutoZone Puerto Rico, AutoZone Texas, and numerous others. Similar to Amazon, AutoZone has fulfillment centers they call “mega hubs” that hold up to one hundred ten thousand units. They are constantly working on opening up more mega hubs in order to lessen

the supply chain issues that they may face. These mega hubs are strategically placed so they can help fulfill orders for nearby stores and customers within twenty-four hours. However, AutoZone is such a big company, they are susceptible to numerous risk factors, including inflation, interest rates, energy prices, supply chain issues, political climate, and global unrest.

III. Risks

A. Inflation

There are many external and internal factors that can pose threats to the success of AutoZone. Inflation is prevalent right now due to supply chain issues caused by the pandemic, the war in Ukraine, and increased household demand. Inflation can have positive and negative effects on the auto parts industry. Gasoline prices have risen almost 40 percent since the pandemic began. This increase negatively affects transportation and shipping costs, which drives expenses up and profits down. Car repairs and parts are up “five percent,” which in turn, decreases business and profits (Bodine). However, inflation in the automobile industry is proving beneficial to the auto parts industry. The price of new and used cars has risen “nine and 24 percent,” respectively (Bodine). People are relying on their older cars for longer, thus requiring more repairs and parts, which increases profits. Additionally, car insurance prices have increased five percent. This increase is motivating more people to drive older cars to reduce their insurance costs, driving AutoZone’s profits up (Bodine).

B. Interest Rates

Another potential risk factor that could affect the success of AutoZone are interest rates. Interest rates have been declining for many years. With a recession ahead, the Federal Reserve has recently been raising interest rates in response to slowing down buying and increasing supply in order to lower inflation. In turn, “the automobile industry is extremely sensitive towards

interest rate hikes” (MSG). Increasing interest rates on shares would likely cause investors to be less inclined to buy AutoZone shares. On the other hand, an increase in interest rates could also lead to consumers being less likely to take out auto loans and more likely to spend money on fixing their pre-existing car rather than taking out a loan for a new car. Additionally, an increase in interest rates means an increase of interest on the pre-existing debt that AutoZone has.

Additionally, the AutoZone 2021 Annual 10-K Report addresses the issue of interest rates in Item 7A. It is stated that their financial market risk is primarily changed from interest rates. They combat this issue by “entering various interest rate hedge instruments” (SEC).

These instruments allow AutoZone to fix issues that higher interest rates cause to the income statement and the balance sheet throughout the period. An increase in interest rates results in a higher amount that the borrower owes. Therefore, rising interest rates result in a greater liability on the balance sheet, such as the loan liability as well as the unpaid interest expense.

C. Energy Prices

An additional risk factor that AutoZone encounters is the energy prices. Increases in energy prices are a threat to AutoZone sales. Increases in energy prices may cause consumers to defer from purchasing AutoZone products, since they may use a higher percentage of their household income to pay for the increased gas prices and other energy costs that have increased. Higher gas prices result in individuals driving their vehicle less, causing less wear and tear on their vehicle and a decrease in demand for repairs and other services AutoZone provides. While increases in gas prices are a threat to AutoZone sales, increases in energy prices could also result in a decline in sales of electric cars, resulting in more people driving their older vehicles and requiring more upkeep and maintenance, driving up AutoZone’s sales. Additionally, an increase

in energy costs also results in an increase in manufacturing costs. AutoZone has international manufacturers and current sanctions on Russia's natural gas and oil increase the overall energy cost, resulting in more expenses to manufacture AutoZone's products.

The condition of energy prices affects the income statement and balance sheet greatly. Higher energy prices could possibly result in an increase of sales revenue, if consumers choose to drive their older vehicles instead of investing in electric cars due to the increase in price. However, higher energy prices could also result in a decrease of sales revenue displayed on the income statement due to higher gas prices resulting in fewer drivers on the road and fewer service requests. Furthermore, higher energy prices and the effect it has on manufacturing could result in a higher cost of goods sold, affecting the income statement and possibly resulting in a lower net income value.

D. Supply Chain

The supply chain is an important factor that contributes to the success of AutoZone. The global supply chain crisis has greatly impacted the auto parts industry and poses a threat to AutoZone's operations. The lack of raw materials available to produce parts is increasing material expense and manufacturing time. AutoZone is having to use third party shipping and trucking companies to transport their products, which increases transportation expenses and shipping time. Additionally, AutoZone's visibility is lacking because they cannot promise quick deliveries, have trouble tracking shipments, and never know when there will be a delay. This not only increases expense, but also decreases business because of the uncertainty. Furthermore, the inability to keep products on the shelves increases expenses because of the wasted space and lack of variability. Although the supply chain has hurt the automobile industry by causing delays in

new cars, the auto parts industry has benefited from the public's use of older cars, which has helped alleviate some of the expenses the supply chain has caused (Manning).

E. Political Climate

The automotive and auto parts industry are reliant on government regulations and are penalized if they do not comply. Whoever is in political power controls these regulations and penalties. Historically, Democratic candidates have promoted more environmentally friendly policies in the automobile industry, including heavy tax credits on electric vehicle purchases. Electric vehicles require 30 percent fewer parts and require less work than regular vehicles, decreasing income and business for the auto parts industry. On the other hand, Republican candidates have taken a different stance on promoting environmentally friendly policies. For instance, the Trump Administration promoted policies on creating standards that would limit greenhouse gas emissions in older vehicles. Policies such as these can implement change while also considering the revenue and jobs these industries provide. AutoZone encounters greater political risk when parties choose to push their own agendas without considering the wider economic effect (Investopedia Team).

F. Global Unrest

Global unrest is another risk factor that AutoZone must take into account. One of AutoZone's biggest international suppliers and manufacturers is in China, such as Dongying Baofeng Auto Parts, located in Shandong (AutoZone). The financial crisis in China has begun to decline due to their "zero Covid-19 policy," resulting in strict lockdowns slowing down their economic growth (MC). A slowdown in China's economic growth has effects well beyond China's borders. A decline in China's supply could result in "higher consumer goods prices worldwide" (MC). Since one of AutoZone's biggest international suppliers is located in China,

this financial crisis could affect the cost of AutoZone's goods, resulting in an increase in costs and therefore an increase in prices of goods for consumers. If AutoZone's prices can no longer compete with their strong competitors, AutoZone's customers might possibly choose to shop at a comparably cheaper store, resulting in a decline of sales revenue on the income statement.

Additionally, other countries rely more heavily on a government-based transportation system, so they do not need private companies to fix private vehicles as much. Therefore, AutoZone doesn't have as strong of a demand in other countries. However, AutoZone could divert some money into obtaining contracts to fix these public transportation vehicles and create more revenue for their company.

IV. Threats to Success

There are multiple factors currently contributing to the company's success in terms of revenue. To fully understand the potential risk factors to the success of AutoZone, it is necessary to understand what is driving its current fiscal success. Supply chain issues sparked by the COVID-19 pandemic caused an increase in the cost of both new and used cars. As a result, people are more wary of buying new cars, and used car sales are increasing. Also, automobiles are simply lasting longer, and consumers are waiting longer to buy new cars. This causes the average age of cars on the road to increase. Older cars need more repairs and parts, so sales for AutoZone have risen. Also, the 10-K report stated that the COVID-19 stimulus packages boosted consumer spending in the years following the pandemic.

Based on this information, the primary threat to AutoZone's success would be for the average age of cars on the road to decrease. This is unlikely to happen in the near future, because used car sales are still increasing. However, the supply chain issues will eventually resolve. This would cause the prices of new cars to decrease, which would encourage consumers to purchase

new cars as opposed to old ones. New cars do not require to be serviced as often, so AutoZone sales would decrease in this scenario. Additionally, these new cars are requiring less service due to the emphasis on purchasing electric cars, due to their eco-friendly nature. However, AutoZone can address the threat of the consequential effects of the supply chain, such as when the supply chain issue resolves and new car sales begin increasing, by expanding their company to offer maintenance and repair services to electric cars. This will open up further revenue opportunities by expanding AutoZone's customer base.

CHAPTER II: AN ESG & CYBERSECURITY RISK ASSESSMENT

I. Introduction of Methods of Analysis

The area of investigation of this case study is the Environmental, Social, and Governance (ESG) and Cybersecurity Risk assessment of AutoZone. This case study analyzes AutoZone's application of ESG criteria and cybersecurity. ESG refers to environmental, social, and corporate governance frameworks that companies utilize. Many different sources were used to gather information about AutoZone. The primary document used was AutoZone's official site. We also used several articles from the business press. In addition, we analyzed reports from news websites and blogs including *MarketWatch*, *SeekingAlpha*, and *YahooFinance*. Multiple search engines such as Google, Bing, Yahoo, and DuckDuckGo were used to obtain a variety of unbiased results.

The main tasks of this case were three-fold. First, we researched AutoZone's position regarding ESG. We found the opportunities and risks concerning ESG that face the public accounting world. We also determined what methods should be used in measuring ESG. Next, we discovered how the international position concerning ESG affects AutoZone. Our other area of focus for this case study was cybersecurity. This involved researching cybersecurity failures on an industry-wide level and a company-specific level. We determined the potential culprits for cybercrime and how AutoZone can protect itself from cybersecurity breaches. Finally, we determined the potential risks for AutoZone with respect to business operations.

We learned many new skills while working on this case. First, we learned how to conduct in-depth research of a specific company using online databases, news articles, and the

blogosphere. We then consolidated this information into bullet points and short phrases.

Teamwork was also an important aspect of this case study. Instead of delegating specific tasks to each group member, we researched every prompt as a group. Overall, we gained many new skills while conducting this case study.

II. Environmental, Social, and Governance, “ESG”

A. Opportunities and Risks

The application of Environmental, Social, and Governance aspects to any company, including AutoZone, adds a whole new sector of the company to monitor. This requires more people to be involved in the company and for more time, meaning that it can cost the company money to make sure that they have all of the appropriate regulations to get their desired ESG score. This gives many third-party organizations including accounting firms, government organizations, banking firms, and many others the opportunity to devote more resources towards a project to monitor and improve a company’s ESG score, meaning they have the opportunity to charge their client for longer hours and more people on the job.

It is important for a company to have a good ESG score because this is something that investors will typically look at prior to investing to see how well the company is adapting to modern-day society. With that being said, ESG can also pose a risk for a company because if they do not have a good ESG score they may not be able to raise the capital needed to continue operations. It also allows the company to make sure it is doing everything in its power to have good environmental, social, and governance practices (“Environmental,” 2021).

B. Challenges in Measuring ESG

While Environmental, Social, and Governance (ESG) aspects of any company are important to consider, an ESG score can be hard to calculate precisely. Since every company

must be measured according to its own practices, and not based on any general standard of comparison, it is hard to have a reliable ESG score. Most companies will go above and beyond to ensure that they have a good ESG score, or at least attempt to appear as if they do.

According to the Harvard Business Review, in the 1970s, the government required car manufacturers to produce passenger-car fleets with a higher average fuel economy. The idea was that the government would set fuel-economy standards for the companies, measure how well their fleets meet those standards, and then compare the standards over time and across companies to pressure the companies with a lower ESG score to improve. While it may have seemed like a great idea that would help reduce carbon emissions at first, it did the exact opposite. These popular car manufacturers shifted their focus from producing cars to producing SUVs and trucks, which did not have these hard regulations at the time (Grenville, 2021).

In the 1970s, SUVs and trucks accounted for only three percent of United States automobile sales but rose to above fifty percent in the early 2000s. This rise in popularity resulted from automobile manufacturers placing a higher emphasis on producing these types of vehicles. This is just one example of the challenges of measuring ESG within the automobile industry. The economy and demand for different types of automobiles are always changing, and so are the regulations for the cars being manufactured. The constant changing of the automobile industry makes it hard to have one standard of comparison for an ESG score (Grenville, 2021).

C. Global ESG

Incorporating ESG practices into global business will have a much stronger impact on the world than only incorporating it in a few small countries. If the entire world is working to make their ESG scores stronger, this will provide a sense of unity and competitiveness that will allow society to grow for the better all at once. Emerging markets are critical for the global economy

because that is where most of the economic growth takes place. For example, half of the world's economic growth in 2020 came from those emerging countries. These emerging markets all have one thing in common. They are careful to incorporate practices that will allow them to develop a good ESG score, which is something that attracts investors to their market ("ESG: The report," 2022).

D. AutoZone and ESG

AutoZone has addressed the concerns developed through ESG and its ratings through its easily accessible website. AutoZone states that they exist to "serve the needs of their customers, the motoring public." ("Environmental," 2021) AutoZone further explains their contributions and response to the COVID-19 pandemic, their environmental responsibilities, their efforts toward DEI (Diversity, Equity, and Inclusion), as well as their contributions towards furthering community engagement.

In response to the COVID-19 pandemic, AutoZone proudly states that they had not "furloughed" or "laid off" any employees due to the pandemic as well as boasted about their "Emergency Time Off Benefits." In response to the rising concerns about environmentally friendly manufacturing and carbon emissions, AutoZone states that they are "committed to decreasing [their] U.S. Scope 1 and Scope 2 energy-related emissions by 15 percent by 2025" ("Environmental," 2021). This decrease is equivalent to "planting nearly 41,000 acres of trees" ("Environmental," 2021). Furthermore, with regard to the social factor of ESG, AutoZone displays its diversity statistics on the ESG module of the AutoZone website. This segment of their website states a wide variety of statistics, suggesting their efforts towards a more diverse population, such as "44 percent of their ethnically diverse employees represent management roles" ("Environmental," 2021).

While AutoZone addresses and has proven to support all three factors of ESG, there could be further improvement in the social factor of ESG if AutoZone expands its diversity in the workplace. A majority of AutoZone's DEI statistics are surrounding data about specifically women or employees that are ethnically diverse; there is no information about their opportunities and benefits in the workforce for disabled or handicapped individuals, veterans, expecting mothers, etc. The lack of expansion on their diversity, equity, and inclusion, to work to include and offer benefits for all employees remains a risk factor for this company.

E. ESG Regulation

Current and future ESG regulations may affect AutoZone's company in a variety of ways. The SEC proposed new regulations on March 22, 2022, that would "impose reporting requirements in companies analogous to those in the UK, marking the first-ever standardized reporting requirements for climate-related information in the U.S." ("The ESG," 2022). This proposed rule will not be the only regulation to be proposed for U.S. companies; the SEC might further regulations to include not only climate change regulations but also social regulations as well.

These ESG-related measures, if consistent with regulations abroad, are focused on key social issues that have become important to those consuming, producing, and investing. An example of this would be eliminating the "importation and consumption of goods produced inhumanely" ("The ESG," 2022). If ESG regulations continue to expand and grow in reliability and popularity, certain measures could negatively impact AutoZone's ability to raise capital. While most automotive companies will struggle with the same factors that go directly against ESG strategies, AutoZone could be affected by stricter regulations on energy related emissions during manufacturing auto parts, as well as the carbon emissions required to ship AutoZone's

products to their distribution centers. Although very few manufacturers and suppliers are located outside of the US region, there are certain suppliers located outside the U.S. that may have to be eliminated due to future regulations that are focused on better conditions for workers, eliminating suppliers and manufacturers outside the U.S. that are overworked and underpaid. If these factors are taken into consideration in the future when determining AutoZone's ESG scores, it is possible that potential consumers and investors might not select AutoZone to do business with.

III. Cybersecurity

A. Failures within the Company and Industry

Cybersecurity has become a more prevalent issue through the rising popularity and implementation of technology in everyday life. Cyber-attacks are not a new phenomenon; however, the reach of cyber-attacks has increased due to the expansion of technology throughout a large number of industries. Cyber-attacks in the automotive industry are not new, nor are they new to AutoZone. In 2015, "a team of security researchers experimented on the vulnerability of autonomous vehicles by hijacking a vehicle" (Abshire, 2021). These vehicles were confirmed to not be as safe as initially thought to be. However, cybersecurity risks are more prevalent in 2022 than ever. Hackers are able to infiltrate "data centers and back-end servers, stealing user data" (Abshire, 2021). Additionally, cyber-attacks can infiltrate "unsecured IT systems and install malware," restricting companies' access to important data (Kosdrosky, 2022). While there was no data indicating that AutoZone has been affected by cyber-attacks, that does not mean that there might not be attacks in the future. These cyber-attacks have proven to be able to hack the automotive industry, which temporarily slows manufacturing and output, as well as furthers the ongoing supply chain issue and chip shortage. The automotive industry and auto parts industry are not immune to cybersecurity threats.

B. Cybersecurity Breachers

As the world continues to utilize and implement technology in every aspect of life, we are opening ourselves up to an increased risk of cybersecurity and crime. With increased technological advancements, use of cloud technologies, and even technology driven vehicles, cyber-crimes are topping the charts of modern crime at one million attacks attempted per day (Norwich University, 2017). Typically, those that commit cyber-crimes are individuals or small groups, but they can also be part of larger groups that work together to share information and tips on crime. They are difficult to identify because of the security measures they take to conceal themselves. These cyber criminals utilize computer systems to uncover and gain access to private data or information for their own financial gain or exploitation of others. According to Verizon's 2021 Data Breach Investigations Report, 86 percent of all breaches were financially motivated (Necula, 2021). Whether it's selling data on the dark web, obtaining data to make fraudulent financial decisions, or utilizing data to blackmail or manipulate others, these cyber criminals have one motive in mind and that is making money (Necula, 2021). Although most cybercriminals are financially motivated, some are politically motivated as well. In their attempt to gain data from information systems, their goal is to harm the government, military, infrastructure, finances, and security of countries for their own political gain (Weimann, 2004).

C. Potential Cybersecurity Risks

AutoZone relies on technology information systems to prepare, conduct, and understand their business practices. According to AutoZone, "Failure to protect or effectively respond to a breach of the privacy and security of customers', suppliers', or AutoZone's information could damage our reputation, subject us to litigation, and cause us to incur substantial costs" ("SEC filing," 2020). If their information systems are attacked, there is increased risk associated with

the business, security of financial assets, and data privacy. A cyber-attack could force location, warehouse distribution, or manufacturing delays or closure which would negatively affect sales and business. If AutoZone is not able to deliver on its promises to deliver products and safeguard information, customer loyalty and AutoZone's reputation will decrease. Employees would also be subject to reduced hours and learning a new system and protocols which would be time consuming and costly. Furthermore, data breaches put the security of financial assets and privacy at risk. For instance, AutoZone offers many payment options, but debit, credit, and electronic payments open them up to a higher risk. Although they have insurance coverage for certain attacks, a data breach of this kind could result in data loss or misuse that breaks the data standards and protocols set by the industry. This breach would result in AutoZone being liable for the compromised actions and would require higher costs to comply with stricter data standards and protocols. Additionally, security breaches could result in a decreased financial rating which would prevent AutoZone from accessing new funds. They would also be subject to audits or investigations by the government which could be costly. ("SEC filing," 2020).

Security breaches not only affect the company but also affect customers and stockholders. Customers should be able to entrust a company with safeguarding their information, so when data is leaked, their trust and confidence in the company decreases. They are also put at risk because their information is compromised. According to research of share prices after a security breach, "After one year, Share price fell -8.6% on average, and underperformed the NASDAQ by -8.6%" (Bischoff, 2021). Stockholders do not want to hold stock that is not going to perform well, and companies tend to underperform for a longer period of time after a security breach due to loss of public confidence (Robinson, 2022). There is great

risk associated with information systems, but AutoZone is taking all necessary steps to ensure they safeguard information.

D. Protection from Cybercrime

AutoZone has taken the necessary steps to protect their employees, customers, and business from cybercrime and are consistently looking for new ways to safeguard their company. They consider information security a top priority, implement security practices across the company, and monitor performance. Their security framework reflects the National Institute of Standards and Technology framework and the Center for Internet Security controls, both of which are leading practices in the industry. They are a certified level one merchant, which is compliant with government payment standards and privacy regulations (“Corporate Sustainability,” 2021). Their Board of Directors and senior management are actively engaged in keeping security measures and protocols up to date, routinely testing and modifying their systems, and complying with all security standards (“SEC filing,” 2020). They hire information technology and cyber security specialists which ensure internal and external parties evaluate and audit their security programs throughout the year. Additionally, their employees are trained and utilize multiple data controls and strategies to mitigate risk. They are required to attend a security awareness training and must agree to comply with AutoZone’s Code of Conduct. This includes learning about data security compliance, password and authentication safeguarding, and training on ethical business practices (“Corporate Sustainability,” 2021).

Although AutoZone has never had a security breach and does a great job at protecting their information, there are always additional steps that can be taken to ensure safety for the company and its customers. As technology continues to evolve, cyber criminals will continue to find new ways to deceive companies and obtain data. 95 percent of breaches are caused by

human error, so it is vital to ensure every employee is continuously educated on new security measures, what to be aware of, and what actions to take if a breach occurs (Cummings, 2021). Security breaches can also be inside jobs, so they should implement strict hiring practices and ensure valuable data is restricted to a limited number of employees. AutoZone should further revise and communicate their recovery plan as well. They should have extensive internal and external input in investigating and revising their plan to ensure it is appropriate for every aspect of the company. Furthermore, AutoZone should investigate the security measures of the third-parties they utilize. If they do not uphold similar standards, AutoZone is opening themselves up to increased risk and undermining their own security (TSMN, 2018). Although AutoZone has implemented extensive security measures, there will always be new steps they can take to safeguard their company.

CHAPTER III: AN AUDIT RISK ASSESSMENT

I. Introduction of Methods of Analysis

The area of investigation of this case study is the audit risk and planning of AutoZone. It analyzes the accounts on the AutoZone balance sheet and income statement whose misstatement would pose the greatest threat to AutoZone. The primary source used to gather information about AutoZone was the yearly 10-K report filed by the company's management. Within this document, we utilized the Exhibits and Financial Statement Schedules under section 15.

The main tasks of this report involved analyzing the balance sheet and income statement, finding the main causes and solutions relating to risk, and summarizing our findings. After determining the riskiest accounts, we posted these accounts to a grid. For each account on this grid, we determined the relevant audit risks, the materiality of the account, and the audit failure risk associated with that account. We determined which tests should be conducted to determine these risks. The tests we decided should be conducted were a test of transactions, test of details, and a substantive test. Specific internal controls may mitigate risk for these accounts such as: segregation of duties, proper authorization, adequate documents and records, physical control, and independent checks. In our summary of risky accounts, we determined the risk associated with misstatement, the critical internal controls for that accounting process, the tests of transactions to audit, and how we would use data analytics to streamline the audit process for that account.

We learned many new skills while working on this case. First, we learned how to conduct in-depth research of a specific company using online databases, news articles, and the

blogosphere. We then consolidated this information into bullet points and short phrases.

Teamwork was also an important aspect of this case study. Instead of delegating specific tasks to each group member, we researched every prompt as a group. Overall, we gained many new skills while conducting this case study.

II. Merchandise Inventory

A. Risk Associated With Misstatement

Merchandise inventory has a very high risk of misstatement because, unlike a lot of the company's accounts, this account is something that is material and can be counted to corroborate the merchandise inventory number. Many different types of control can help record and protect this merchandise inventory account. For example, AutoZone has physical controls such as employee ID cards, security, fireproof measures, database locks, and software built into their systems that leaves little room for any miscalculation of inventory. However, human error can eliminate the assurance provided by the controls within inventory systems if numerous mistakes are made and unchecked. The constant inflow and outflow of inventory is where most of the mistakes in calculating inventory are made.

For example, AutoZone has the option to negotiate, per the terms of the purchase contract, either free on-board shipping or free on-board destination to establish the inventory they have in their possession. While they deviate in the standard method of practice they use, the use of free on-board shipping means that they can count the inventory in their merchandising inventory account once they pay for the shipping to themselves, and free on-board destination means they cannot include this merchandise into their accounts until after it is received and paid for. According to AutoZone's 10K, they also occasionally donate leftover inventory to nonprofit

organizations. It is important that controls are done periodically to corroborate if the number in the merchandise inventory account is accurate.

B. Critical Internal Controls

Accounting for merchandise inventory is difficult because it is large and material, is easily susceptible to being lost, stolen, or miscounted, and requires many steps to be recorded and reported accurately. Implementing internal controls can benefit AutoZone in managing inventory, mitigating risk, and ensuring relevance and faithful representation in their financial reporting. Autozone maintains various large amounts of inventory and records that must be safeguarded. Physical controls, such as gates and security for locations, passwords and authentication for online records, and specific policies and procedures for inventory recording and storage are essential to ensuring the safety and security of inventory (“An Auditor's Perspective,” 2015). Without these specific controls, inventory could easily get miscounted, misplaced, or misstated which would directly affect the recording and reporting of financial statements.

Maintaining adequate documents and records for merchandise inventory is also essential to mitigating risk. Utilizing information technology controls, such as an inventory management system within the company, can assist in managing inventory levels to avoid overstock and storage costs (“Using Internal Controls,” 2022). Having policies and procedures that all employees are trained on, such as preparing invoices, maintaining transportation and shipping slips, and using forms for disposal or damaged inventory are essential to keeping an organized and accurate record with the large amount of inventory AutoZone holds (Schwartz, 2022). Each of these controls are essential to ensuring the balance sheet is correct which is important because

it indicates the success and need for improvement in the company (“Using Internal Controls,” 2022).

C. Substantive Tests

Substantive testing is used by the auditor to obtain the “audit evidence in order to support the auditor’s opinion” (Sinra). A type of substantive testing used detail testing, “where the main objective is to verify the balances, transactions, and disclosures of financial statements” (Sinra). While merchandise inventory is an account that is associated with a high risk of misstatement, there are substantive tests that the AutoZone auditor can do to gather evidence to prove that the account is not misstated. It is important to maintain adequate documents and records for the merchandise inventory account, as it is difficult to account for every unit of inventory. The auditor can conduct a test of details of transactions, to gather evidence for each transaction recorded in merchandise inventory. A test of transactions allows the auditor to verify that all transactions are properly stated and authorized, which also helps to confirm that each transaction is posted with the correct amount (Gandhi). This substantive test allows the auditor to check over the account for existence, verifying that the transactions in the account and its relevant assets exist.

D. Data Analytics

Data visualization can be used to analyze more transactions in less time. Data analytics can be used to visualize merchandise inventory by tracking the number of items in stock, the average time it takes to sell an item, and the average cost of an item. This information can be used to identify trends and optimize inventory levels. Using data visualization and data query tools can account for more processes than using a manual approach.

III. Operating Leases/ Debt

A. Risk Associated With Misstatement

AutoZone currently has a significant lease account and debt account. They want to show these accounts as small as possible to make it look like the company does not have a lot of debt. However, it is important that all of this information is recorded accurately in order to limit the risks of a misstatement. If this account is not accurate it will cause the working capital ratio to be false, showing liabilities as either too high or too low. Since this is not a fair representation of the company's true liabilities they can get in trouble with the Securities and Exchange Commission for falsely reporting this information. Fortunately, there are many controls AutoZone uses to regulate the correct numbers in these accounts.

B. Critical Internal Controls

AutoZone is constantly looking to expand, and since they don't offer franchising, they are involved in the purchasing and leasing of their commercial properties. Implementing controls of independent checks and ensuring adequate financial documents and records are essential to mitigating risk and following the lease standards set by the Financial Accounting Standards Board (FASB). Under the ASC 842 standard for lease accounting, all leases longer than 12 months must be recorded as assets and liabilities on the balance sheet. It is important that AutoZone implements a plan to ensure all documents and records are accurate for this reporting. They should require documents and forms that confirm and report a lease's type, components, and classifications so they are reported correctly on the balance sheet and are in compliance with the Generally Accepted Accounting Principles ("Accounting for Leases," 2022). Additionally, they should ensure their leasing system is consistent with the standards and is consistently updated.

Each of these forms, tasks, and reports should have independent checks to ensure neutrality, reliability, and completeness. Managers should review and verify the information collected and recorded is correct. They should ensure all reporting is made in a timely manner and is performed in accordance with the standards. Without an additional set of eyes, the financial statements and reporting of leasing information could be incorrect and not up to standard. The employees must hold each other accountable to mitigate the over or understatement of operating lease and debt to ensure relevance and faithful representation in their financial statements.

C. Substantive Tests

The auditors can use a variety of substantive tests to gather audit evidence and check the operating lease/debt account for completeness, accuracy, and validity. An auditor could use a test of details of account balances in order to verify completeness for the operating lease/debt account. This test checks for completeness of the account to make sure that debt outstanding is listed correctly and that the liabilities are recorded correctly, as management is more likely to understate their liabilities and debt expenses. Another test that could be done to verify the existence of the account is to make sure that all the transactions in the account exist and have a related credit or debit balance. For example, the auditor can check to make sure that a decrease in the operating lease/debt account has a related decrease in an asset account.

D. Data Analytics

Data analytics can be used to keep track of debt accounts by monitoring patterns in customer behavior and using predictive modeling to forecast future behavior. This information can be used to make decisions about marketing, collections, and other strategies to improve

customer satisfaction and reduce delinquencies. Debt accounts can be monitored by automatic robot processes designed to keep track of debt levels.

IV. Accumulated Depreciation

A. Risk Associated With Misstatement

Accumulated depreciation is important to get accurate because if it is wrong it can affect other accounts as well. If there is more depreciation than there should be, the account may be moving the excess money from the inventory account, making the account less than it should be. There could also be too low of a depreciation account, making the inventory account more than it should be. This account is important to get accurate information accounted for because it can have a cause and effect relationship with other accounts that will render them inaccurate if it is not correct. Fortunately, there are numerous controls that AutoZone has put in place to regulate the correct recording of the accumulated depreciation account.

B. Critical Internal Controls

Accounting for accumulated depreciation is difficult because companies are required to use specific methods to depreciate their assets and these methods involve some aspects of estimation. These estimations can in turn affect other accounts in the financial statements. It is important to utilize internal controls to mitigate any risk of misstatement in both the recording and reporting of accumulated depreciation. Segregation of duties is essential to safeguarding and examining the use of assets. AutoZone owns various types of property, plant, and equipment that require the recording of depreciation. It is important that the purchase, use, inspection, and safeguarding of an asset is completed by different people for unbiased recording and reporting of the asset (Hall, 2021). If these procedures are not followed, the asset is likely to be overstated to make the company look good, which can be influential in misstating other accounts. Without

segregation of duties, there would be a single opinion which is not enough to sufficiently assess inventory, damage, or estimates. Segregation of duties holds the company and its employees accountable.

Financial controls are also very important in holding the company accountable and ensuring its financial records are accurate. You must have policies in place that can be followed to determine the acquisition cost, depreciation method, frequency of recording, disposal, and who determines and records each of these to keep the recording constant across each asset. Without these policies, the recording and reporting of these factors could under or overstate the balance sheet which could affect the company's profit, taxes, and ability to receive funding for other capital expenditures (Hoare, 2022). Additionally, it is important to have these controls in place to promote decision usefulness for the company and its customers. These can ensure the financial statements are relevant and faithfully representative of the company. Implementing these internal controls will ensure the recording and reporting of accumulated depreciation is not misstated.

C. Substantive Tests

While accounting for accumulated depreciation can be difficult as it is estimated, the accumulated depreciation account still needs to be verified for completeness, existence, and validity. A substantive test that should be performed on this account would be a test of valuation to determine if the depreciation expense was valued at the correct amount. Another substantive test would be the test of details on the accumulated depreciation account, which would verify the existence and completeness of adjusting entry estimates and depreciation estimates.

D. Data Analytics

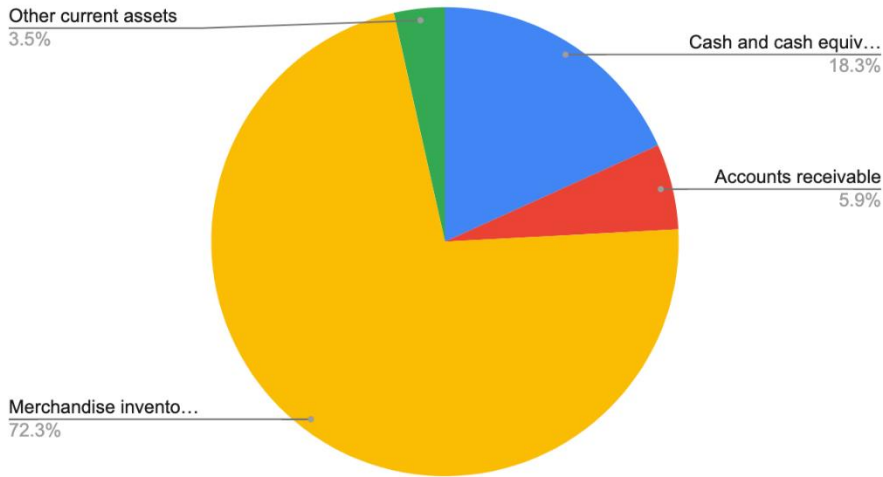
There are many ways that data analytics can be used to keep track of accumulated depreciation accounts. Some methods include using data analytics to track: the total amount of depreciation that has been recorded for each asset, the average rate of depreciation for each asset, the total amount of depreciation expense that has been recorded in the accounting period, the total amount of depreciation that has been recorded for each category of assets, the total amount of depreciation that has been recorded for each depreciation method. Data queries and machine learning processes can shorten the amount of time used in substantive tests, and produce more accurate results.

V. Current Assets and Current Liabilities Accounts

The charts below depict the current assets and current liability accounts of AutoZone in 2021. In 2021, AutoZone's current assets totaled \$6,415,303. In the current assets chart, merchandise inventory is a substantial percentage of the current assets, followed by cash and cash equivalents. Accounts receivable and other current assets only make up a nominal amount of the total current assets. In 2021, AutoZone's current liabilities totaled \$7,369,754. The current liabilities chart shows accounts payable being the main concern of debt, followed by accrued expenses. Even though AutoZone has a lot more liabilities than assets, this is common in the retail industry because the suppliers of AutoZone know that they are a reliable company that will pay off debts over time.

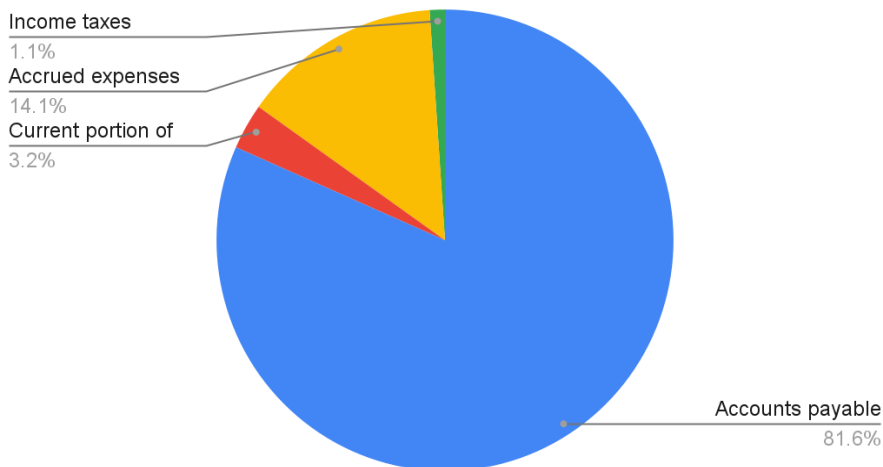
2021 AutoZone Current Assets:

Current Assets



2021 AutoZone Current Liabilities:

Current Liabilities



VI. Conclusion

After examining AutoZone’s 10-K report and their financial statements, we reviewed the risks of the merchandise inventory, operating leases, and accumulated depreciation accounts. We investigated internal controls, substantive tests, and data analytics auditors would look for and

utilize in ensuring the company's recording and reporting is in accordance with the Generally Accepted Accounting Principles and standards of financial reporting. Each of these provide companies, such as AutoZone, the controls and standards to hold themselves accountable and ensure relevant and faithful financial reporting.

CHAPTER IV: A TAX RISK ASSESSMENT

I. Introduction of Methods of Analysis

The area of investigation of this case study is the tax risk and planning of AutoZone. The primary source used to gather information about AutoZone was the yearly 10-K report filed by the company's management. It was important to look at tax implementations at a state, federal, and international level since AutoZone is a large company that will need to utilize these different policies to its advantage. We also considered the different tax changes that are made when there is a new party in power and how this transfer of power can affect companies, both large and small, when it comes to implementing a tax strategy.

The main tasks of this report involved looking into various ways to minimize AutoZone's legal cash tax payments. It was also important for us to investigate the possibility of AutoZone expanding, divesting, or restructuring its current operations. This would be another way to help minimize taxes. The tax strategies we researched were both short-term and long-term. It is important to implement both short and long-term strategies with AutoZone to maximize the number of tax credits the company is able to deduct. AutoZone, similar to any other successful company, should provide the lowest taxable income possible in order to maximize its profits and have more money to reinvest back into the company or use as new capital to improve other aspects of the company.

We learned many new skills while working on this case. First, we learned how to conduct in-depth research on a specific company using online databases, news articles, and the blogosphere. This case differed from the others because there was more critical thinking involved, so teamwork was also an important aspect of this case study. Instead of delegating specific tasks to each group member, we researched every prompt as a group. Overall, we gained many new skills while conducting this case study.

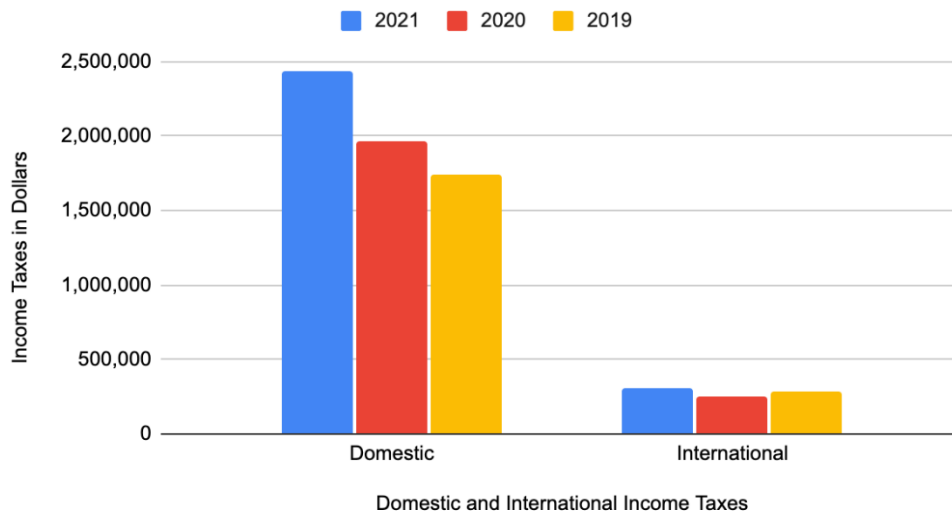
II. Tax at a Macro Level

Taxes are an essential part of keeping governments upright throughout the world. With that being said, it is important for any successful company to have a good tax strategy. It is also important for AutoZone to constantly update its tax strategy due to new parties taking office and changing tax policies often. The domestic tax rate has stayed the same for the past few years. However, international tax has doubled within the past few years. This is a strategy the United States uses to keep more business within the United States and increase job opportunities within the company.

Since companies can be taxed at a state, federal, and international level it is very important for AutoZone to strategically align specific parts of their company into places that would have a lower tax rate. Companies should bring their division overseas and pay higher taxes back into the United States in order to avoid paying high US taxes with a high-profit margin. It is important for a company to find a country where taxes are not at a high rate. There is also a tax benefit for producing in the United States instead of outsourcing production. As you can see in the chart below, AutoZone uses this tax strategy and pays domestic and international taxes.

AutoZone's Income Taxes – Domestic vs. International:

AutoZone's Income Taxes



III. Tax Credits/Deductions Applicable to AutoZone

AutoZone has used a variety of tax credits to incur a reduction on their taxable income. Many companies look to build new locations in zones where states allow for tax deductions in order to promote business or increase the value of the specified location. One of the most common tax credits that AutoZone receives is the enterprise zone tax credit. Different states have varying types of tax credits that pertain to zones. If a company establishes in a marked zone, states can offer a tax deduction for improving the value of that zone. For example, the enterprise zone tax credit program is a Colorado program that provides tax credits to businesses, such as AutoZone, that invest in expanding or improving buildings located within certain zones of a state (“Enterprise,” 2022). Within the past 5 years, AutoZone has received enterprise zone tax credits from states such as Colorado, Florida, California, Arizona, and New York (“AutoZone,” 2022). Additionally, another tax reduction that AutoZone has filed for in the past is a property tax abatement. Property tax abatements decrease the amount of taxes owed for a certain period and

are offered to incentivize the “construction or renovation of buildings that include a share of affordable units” (“Tax,” 2022). This tax credit encourages business owners to improve lower-cost units and buildings in exchange for a lower tax bill. For example, in 2017, AutoZone received a property tax abatement of \$3,897 for an AutoZone location in Maine (“AutoZone,” 2022). Another tax credit that AutoZone has received is the job expansion tax credit/rebate. This tax rebate offers a tax credit to AutoZone for hiring employees from “certain targeted groups” (“Work Opportunity,” 2022). These additional tax credits offer various opportunities for tax reduction and benefits for businesses looking to reduce tax amounts and increase income.

IV. Expansion Plan

As previously stated, AutoZone has received enterprise zone tax credits from states such as Colorado, Florida, California, Arizona, and New York. To help further decrease the tax burden, AutoZone can continue to apply to receive enterprise zone tax credits in other states. To begin with, Texas has the most AutoZone stores of any state, and it is not currently receiving enterprise zone tax credits. The Texas Economic Development Office provides the Enterprise Zone Program Application form on its website. Companies that have Enterprise zone designation are eligible to receive state sales and use tax refunds on qualified expenses. The Texas Comptroller’s office provides forms for certain tax refunds. AutoZone can use Form 00-957 to claim an assigned refund on sales and use tax.

Furthermore, AutoZone has utilized job expansion tax credits in the past to lessen the tax burden. One specific tax credit that the Internal Revenue Service offers is the Work Opportunity Tax Credit. According to the IRS, “The Work Opportunity Tax Credit (WOTC) is a Federal tax credit available to employers for hiring and employing individuals from certain targeted groups

who have faced significant barriers to employment.” AutoZone can use Forms 5884 and 3800 once they have received certification from the IRS for this tax credit. Form 5884 is used by corporations to state the work opportunity credit for qualified first- and second-year wages paid to or incurred for targeted group employees during the tax year. AutoZone must claim the work opportunity credit any time within 3 years of the due date of the tax return (“Work Opportunity,” 2022).

V. Expected Tax Savings

If AutoZone investigated expanding its use of enterprise zone tax credits in Texas, it would be a short-term solution, but if they utilized this in multiple states, it would be a long-term and substantial solution. For instance, Texas’ Enterprise Zone Program incentivizes private investment and job creation in economically distressed areas by its state sales and tax refund program (“Texas,” 2022). Depending on the size of the enterprise project, AutoZone could receive up to \$625,000 for the type of project and jobs it would create in these areas. This is a short-term solution because the payout period is one to five years. Additionally, there is a limited number of designations per population and biennium (“Texas,” 2022), so attaining this designation for long periods and in multiple parts of the state would be difficult but could still prove beneficial. There are currently 43 states that provide enterprise zone tax credits. Each state defines its eligibility and credit amount but utilizing this type of tax credit across the United States would provide a long-term substantial solution.

The Work Opportunity Tax Credit varies by target group. It can provide credits up to \$9,600 for each qualified hire and can be claimed for two years (“What’s the Work,” 2022). According to AutoZone, almost 10 percent of their employees serve in the armed forces or are veterans. This is the target group that qualifies for the highest level of credit. Since AutoZone is already employing active military and veterans, they should implement this tax credit because it would

substantially benefit them. According to the Internal Revenue Service, “The Consolidated Appropriations Act, 2021 authorized the extension of the WOTC until December 31, 2025.” This is another short-term tax credit that could be applied to not only reduce tax liability but also increase diversity and opportunity within the company.

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